

Report
of the
Examination of
American Standard Insurance Company of Wisconsin
Madison, Wisconsin
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

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February 7, 2002

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Commissioners:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

AMERICAN STANDARD INSURANCE COMPANY OF WISCONSIN

Madison, Wisconsin

and this report is respectfully submitted

I. INTRODUCTION

The previous examination of the company was conducted in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain

documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

American Standard Insurance Company of Wisconsin (ASIC) cedes 100% of its direct writings to American Family Mutual Insurance Company (AFMIC). Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance for the examination of AFMIC. Their reviewed covered the adequacy of the company's loss reserves and loss adjustment expense reserves of AFMIC, which includes the assumed loss reserves from ASIC. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

American Standard Insurance Company of Wisconsin (ASIC) is a stock property and casualty insurer, organized in 1961 under the provisions of ch. 611, Wis. Stat., as the American Standard Insurance Company. The current name was adopted in 1962. ASIC is a wholly owned subsidiary of American Family Mutual Insurance Company (AFMIC) through its downstream holding company, AmFam, Inc. Collectively AFMIC and subsidiaries are known as the American Family Group.

The company writes direct premium in the following states (in 2001):

Wisconsin	\$94,285,928	18.3%
Missouri	79,024,598	15.4
Arizona	59,625,649	11.6
Colorado	58,115,243	11.3
Minnesota	51,337,563	10.0
All others	<u>171,749,504</u>	<u>33.4</u>
	<u>\$514,138,485</u>	<u>100.0%</u>

The company is currently licensed in the following states, with North Carolina and South Carolina added in 2002:

Arizona	Colorado	Idaho
Illinois	Indiana	Iowa
Kansas	Minnesota	Missouri
Montana	Nebraska	Nevada
New Mexico	North Carolina	North Dakota
Ohio	Oregon	South Carolina
South Dakota	Utah	Washington
Wisconsin		

ASIC is limited to providing insurance for motorcycles and for marginal and substandard private passenger automobile risks. ASIC's direct writings are 100% ceded to AFMIC. Marketing is accomplished through AFMIC's general agency network.

The following table is a summary of the net insurance premiums written by the company in 2001. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Ceded	Net Premium
Private passenger auto liability	\$319,885,287	\$319,885,287	\$0
Commercial auto liability	902	902	0
Auto physical damage	<u>194,252,296</u>	<u>194,252,296</u>	<u>0</u>
Total All Lines	<u>\$514,138,485</u>	<u>\$514,138,485</u>	<u>\$0</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors is elected annually, and consists of five members, each of whom is an officer of AFMIC. As inside directors, they receive no additional compensation for serving on the board. Currently the board of directors consists of the following persons:

Name	Principal Occupation
David R. Anderson	President and Chief Operating Officer
Daniel R. DeSalvo	Executive Vice President – Sales
James F. Eldridge	Executive Vice President – Legal; Secretary
John B. Johnson	Executive Vice President – Finance, Treasurer
Harvey R. Pierce	Chairman of the Board and C.E.O.

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2001 Compensation
Harvey R. Pierce	Chairman of the Board and C.E.O.	\$1,439,020*
David R. Anderson	President and Chief Operating Officer	836,786*
James F. Eldridge	Executive Vice President- Legal; Secretary	464,364*
John Brent Johnson	Executive Vice President- Finance; Treasurer	
548,041*		

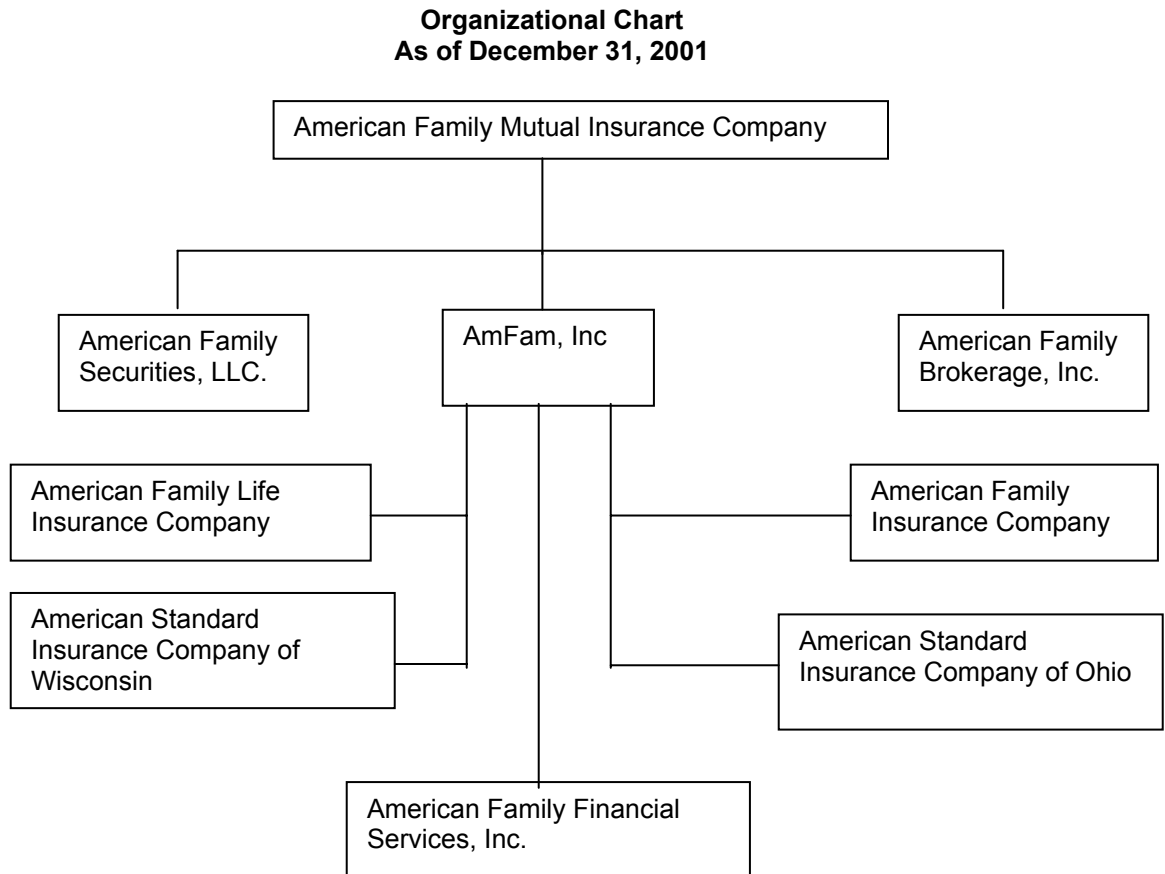
* Compensation is noted above is on an American Family Group basis, and includes amounts allocated to all affiliates.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. There were no committees appointed by the board at the time of the examination. The committees of the ultimate controlling party, AFMIC, govern the company.

IV. AFFILIATED COMPANIES

American Standard Insurance Company of Wisconsin (ASIC) is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of ASIC follows the organizational chart.



American Family Mutual Insurance Company

American Family Mutual Insurance Company (AFMIC) is the parent of the holding company system referenced above. AFMIC was organized in 1927, and writes primarily auto and homeowner's coverage in 22 states. AFMIC 100% assumes the business written by its downstream property and casualty subsidiaries. As of December 31, 2001 AFMIC reported assets of \$6.8 billion and liabilities of \$4.2 billion, and unassigned funds of \$2.6 billion.

Operations for 2001 produced net income of \$11 million. AFMIC was examined concurrently with the ASIC examination. The results of that examination are described in a separate report.

AmFam, Inc.

AmFam, Inc., was incorporated in 1981 to serve as a downstream holding company for the American Family Insurance Group. As of December 31, 2001, the company's consolidated audited GAAP basis financial statement reported assets of \$4.2 billion, liabilities of \$3.3 billion and stockholder's equity of \$900 million. Of that amount, all but approximately \$241,000 was derived from the value of subsidiaries.

American Family Brokerage, Inc.

American Family Brokerage, Inc., was incorporated in 1985, to provide brokerage services for insurance placements beyond the coverage or limits available through the American Family Insurance Group. As of December 31, 2001, the company's audited GAAP basis financial statement reported assets of \$1.5 million, liabilities of \$1.34 million, and stockholder's equity of \$165,000. Operations for 2001 produced a net income of \$192,000.

American Family Securities, LLC

American Family Securities, LLC (AFS), was incorporated on July 14, 2000, with a capital contribution of \$250,000 from AFMIC, as a limited liability company whose sole member is AFMIC. AFS is a non-clearing, registered broker dealer acting as the principal underwriter for American Family Life Insurance Company's (AFLIC) new variable life and annuity products. On March 23, 2001, AFS was admitted into the National Association of Securities Dealers (NASD) to sell AFLIC's variable products. As of December 31, 2001, the company's audited GAAP basis financial statement reported member's equity of \$264,000. Operations for 2001 produced a net income of \$11,000.

American Family Financial Services, Inc.

American Family Financial Services, Inc. (AFFS), was acquired by American Family Insurance Group in 1969, to provide direct loans and leases, primarily to policyholders. It offers these products through AFMIC's multi-line, exclusive agency force in twenty-two states. As of December 31, 2001, the company's audited GAAP basis financial statement reported assets of

\$202.3 million, liabilities of \$180 million, and stockholder's equity of \$22.7 million. Operations for 2001 produced a net income of \$721,000.

AFFS finances its loan portfolio primarily through the sale of commercial paper. In order to allow the company to receive the best possible interest rates, AFMIC has agreed to guarantee the debt of AFFS. In 1998 the Board of Directors of AFMIC authorized an increase in the guarantee limit to \$375 million. As of December 31, 2001, AFFS outstanding guaranteed debt totaled \$92 million. In addition, both AFMIC and AFLIC may lend AFFS additional funds through the use of short-term notes. As of December 31, 2001, there were no outstanding short-term notes issued by AFFS owed to an affiliate.

American Family Life Insurance Company

American Family Life Insurance Company (AFLIC) was incorporated in 1957. The company is currently licensed in 23 states, and writes primarily ordinary life insurance, including traditional and universal life products. During 2001 the company obtained authorization to start writing variable life and annuity products. As of December 31, 2001, AFLIC reported assets of \$2.7 billion, liabilities of \$2.4 billion (both amounts include \$3.5 million from separate accounts), and surplus of \$243 million. AFLIC was examined concurrently with the ASIC examination. The results of the examination are described within a separate report.

American Standard Insurance Company of Ohio

American Standard Insurance Company of Ohio (ASICO) was incorporated in Ohio in 1995 and writes business only in that state. ASICO was founded for the purposes of operating efficiencies and state tax savings. ASICO directly writes lines of business identical to ASIC's and cedes that business to AFMIC through a 100% quota share agreement. As of December 31, 2001, ASICO reported assets of \$25.8 million, liabilities of \$21.6 million and policyholders' surplus of \$4.2 million. Operations for 2001 produced a net income of approximately \$425,000.

American Family Insurance Company

American Family Insurance Company (AFIC) was incorporated in Ohio in 1995 and writes business only in that state. AFIC was founded for the purposes of operating efficiencies

and state tax savings. AFIC directly writes lines of business identical to American Family Mutual Insurance Company (AFMIC). The direct writings are then ceded to AFMIC through a 100% quota share agreement. As of December 31, 2001, AFIC reported assets of \$59.7 million, liabilities of \$52 million and policyholders' surplus of \$7.7 million. Operations of 2001 produced net income of approximately \$663,000.

Affiliated Agreements

In 1995, AFMIC developed an inter-company cost allocation agreement for the reimbursement of expenses paid by AFMIC on behalf of its affiliates. Allocated costs are based on the actual cost of providing the service multiplied by the affiliate's proportionate share of the benefit conferred. Refer to the "Summary of Examination Results" section of this report for further discussion on this topic.

Effective April 29, 2002, AFMIC and affiliates entered into a restated tax allocation agreement for the purpose of filing federal income tax returns on a consolidated basis. The tax liability of the group is allocated to individual member companies in accordance with Internal Revenue Service regulations. Each participating affiliate reimburses AFMIC for payment of the affiliate's portion of liability included in the consolidated tax liability, and each respective affiliate receives its pro-rata share of consolidation-basis tax benefits.

V. REINSURANCE

As noted in the "History and Plan of Operation" section, ASIC cedes 100% of its direct writings to AFMIC. Effective October 1, 1999, the contract was restated and signed by both parties. The contract contained the proper insolvency provision. In 2001, this business represented 13% of AFMIC's gross written premium. ASIC's writings are primarily nonstandard personal lines automobile business.

In connection with the reinsurance agreement, AFMIC (Buyer) and ASIC (Seller) entered into an agreement for the sale of ASIC's premium receivable. The contract was approved by this office and became effective on January 1, 2000. Under the terms of the agreement, the Buyer agrees to purchase the Seller's premium receivable at the end of the month, with no discount, beginning January 2000. Settlement is to be made within five days of the transfer. The motivation for the sale of premium receivables by ASIC was that the routine intercompany balances were becoming so large that ASIC could not settle them with AFMIC by using only its short-term investments, and ASIC did not want to liquidate its long-term investments to settle intercompany accounts.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

American Standard Insurance Company of Wisconsin
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$206,004,034	\$	\$206,004,034
Cash	2,361,300		2,361,300
Short-term investments	14,497,634		14,497,634
Receivable for securities	1,335		1,335
Agents' balances or uncollected premiums:			
Premiums, agents' balances, and installments booked but deferred and not yet due	(2,498,122)		(2,498,122)
Guaranty funds receivable or on deposit	146,865	13,221	133,644
Interest, dividends, and real estate income due and accrued	3,192,061		3,192,061
Receivable from parent, subsidiaries, and affiliates	50,854,675		50,854,675
Write-ins for other than invested assets			
Cash items	(3,495)	(3,495)	0
Total Assets	<u>\$274,556,287</u>	<u>\$9,726</u>	<u>\$274,546,561</u>

American Standard Insurance Company of Wisconsin
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Federal and foreign income taxes	\$ 286,757
Amounts withheld or retained by company for account of others	5,393
Remittances and items not allocated	2,207,622
Drafts outstanding	51,189,939
Payable to parent, subsidiaries, and affiliates	34,448,164
Write-ins for liabilities:	
Liability for checks and drafts	1,418,539
Suspense, validations and clearing accounts	94,489
AP to vendor	<u>2,192,814</u>
Total Liabilities	91,843,717
Common capital stock	3,000,000
Gross paid in and contributed surplus	3,000,000
Unassigned funds (surplus)	<u>176,702,844</u>
Surplus as Regards Policyholders	<u>182,702,844</u>
Total Liabilities and Surplus	<u>\$274,546,561</u>

**American Standard Insurance Company of Wisconsin
Summary of Operations
For the Year 2001**

Underwriting Income

Premiums earned	\$ 0
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Deductions:

Total underwriting deductions	0
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Net underwriting gain or (loss)	0
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Investment Income

Net investment income earned	11,367,854
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Net realized capital gains or (losses)	182
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Net investment gain or (loss)	11,368,036
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Other Income

Total other income	0
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Net income (loss) before federal and foreign income taxes	11,368,036
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Federal and foreign income taxes incurred	1,299,164
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Net Income	<u>\$10,068,872</u>
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American Standard Insurance Company of Wisconsin
Cash Flow
As of December 31, 2001

Premiums collected net of reinsurance	\$2,767,558	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	<u>(5,338,435)</u>	
Cash from underwriting		\$8,105,993
Investment income (net of investment expense)		11,220,509
Other income (expenses):		
Net amount withheld or retained for account of others	<u>(6,496)</u>	
Total other income		(6,496)
Deduct:		
Federal income taxes paid (recovered)	<u>1,024,891</u>	
Net cash from operations		\$18,295,115
Proceeds from investments sold, matured, or repaid:		
Bonds	<u>10,311,540</u>	
Total investment proceeds		10,311,540
Cost of investments acquired (long-term only):		
Bonds	<u>30,872,364</u>	
Total investments acquired		<u>30,872,364</u>
Net cash from investments		(20,560,824)
Cash provided from financing and miscellaneous sources:		
Surplus notes, capital and surplus paid in	2,250,000	
Other cash provided	<u>2,258,695</u>	
Total		4,508,695
Cash applied for financing and miscellaneous uses:		
Net transfers to affiliates	<u>3,175,724</u>	
Total		<u>3,175,724</u>
Net cash from financing and miscellaneous sources		<u>1,332,971</u>
Net change in cash and short-term investments		(932,738)
Reconciliation		
Cash and short-term investments, December 31, 2000		<u>17,791,674</u>
Cash and short-term investments, December 31, 2001		<u>\$16,858,936</u>

**American Standard Insurance Company of Wisconsin
Compulsory and Security Surplus Calculation
December 31, 2001**

Assets	\$274,546,561	
Less security surplus of insurance subsidiaries	0	
Less liabilities	91,843,717	
Adjusted surplus		\$182,702,844
Annual premium:		
Lines other than accident and health	0	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million		<u>2,000,000</u>
Compulsory surplus excess (or deficit)		<u>\$180,702,844</u>
Adjusted surplus (from above)		\$182,702,844
Security surplus:		
(140% of compulsory surplus, factor reduced 1% for each		
\$33 million in premium written in excess of		
\$10 million, with a minimum factor of 110%)		<u>2,800,000</u>
Security surplus excess (or deficit)		<u>\$179,902,844</u>

**American Standard Insurance Company of Wisconsin
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$ 141,452,183	\$148,004,145	\$153,953,108	\$159,638,165	\$170,466,209
Net income	7,217,329	6,295,705	6,199,483	8,981,574	10,068,872
Change in net deferred income tax					(29,521)
Change in non-admitted assets	(665,367)	(346,742)	(514,426)	1,846,470	204,519
Cumulative effect of changes in accounting principles					(257,236)
Capital changes:					
Paid in					500,000
Surplus adjustments:					
Paid in					1,750,000
Surplus, end of year	<u>\$148,004,145</u>	<u>\$153,953,108</u>	<u>\$159,638,165</u>	<u>\$170,466,209</u>	<u>\$182,702,843</u>

**American Standard Insurance Company of Wisconsin
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. There were no exceptional ratios.

	Ratio	1997	1998	1999	2000	2001
#1	Gross Premium to Surplus	284.0%	284.0%	290%	261.0%	281.0%
#2	Net Premium to Surplus	0.0	0.0	0.0	0.0	0.0
#3	Change in Net Writings	0.0	0.0	0.0	0.0	0.0
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	0.0	0.0	0.0	0.0	0.0
#6	Investment Yield	6.0	5.4	5.7	6.3	5.4
#7	Change in Surplus	5.0	4.0	4.0	7.0	7.0
#8	Liabilities to Liquid Assets	21.0	23.0	38.0	37.0	41.0
#9	Agents' Balances to Surplus	3.0	3.0	3.0	0.0	0.0
#10	One-Year Reserve Devel. to Surplus	0.0	0.0	0.0	0.0	0.0
#11	Two-Year Reserve Devel. to Surplus	0.0	0.0	0.0	0.0	0.0
#12	Estimated Current Reserve Def. To Surplus	0.0	0.0	0.0	0.0	0.0

Growth of American Standard Insurance Company of Wisconsin

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1997	\$185,032,697	\$37,028,552	\$148,004,145	\$7,217,329
1998	193,688,736	39,735,628	153,953,108	6,295,704
1999	244,223,362	84,585,197	159,638,165	6,199,483
2000	245,916,792	75,450,581	170,466,210	8,981,574
2001	274,546,561	91,843,719	182,702,844	10,068,872

Year	Gross Liability Premium Written	Gross Liability Losses Paid	Percentage	Gross Property Premium Written	Gross Property Losses Paid	Percentage
1997	\$279,877,864	\$176,050,503	63%	\$140,112,574	\$101,001,075	72%
1998	286,885,237	175,912,944	61	150,883,226	100,442,967	67
1999	299,040,639	171,440,631	57	163,661,301	94,443,525	58
2000	280,585,103	181,187,987	65	163,587,402	114,702,893	70
2001	319,886,189	114,702,893	36	194,252,296	141,368,153	73

As previously stated, ASIC cedes its writings 100% to AFMIC and uses the same agency system. The table above shows similar increases in loss percentages relating to the severe storms that hit the company's main area of operation during 2000 and 2001.

For 1999, the increase in admitted assets was largely due to changing policy terms from three months to six months. This resulted in an increased deferred premium asset. This change also affected the liabilities by increasing affiliated payables for premiums ceded to AFMIC. For 2000, the liabilities were affected by the sale of ASIC's premium receivable to AFMIC. The sale decreased the amount of premium owing AFMIC at year-end, which decreased affiliated payables. A discussion on this agreement is in the Reinsurance Section. Refer to the Summary of Examination Results section for further discussion on reinsurance premiums and affiliated balances.

During 2001, the company issued an additional 1000 shares of \$500 par value common stock to its parent company AmFam, Inc. In total, the parent company paid in \$2,250,000 (\$500,000 in paid in capital and \$1,750,000 in paid in surplus) to help ASIC meet the capital requirements of licensing in new states. Losses in 2001 increased significantly due to heavy storms hitting the Midwest area.

Reconciliation of Surplus as per Examination

The examination made no adjustments to the company's reported surplus as regards policyholders or reclassifications of any balance sheet items.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There was one specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Finance Committee—It is recommended that the company amend its bylaws to allow for the appropriate delegation of managerial authority to committee.

Action—Compliance

Summary of Current Examination Results

Financial Reporting – Schedule Y

During the review of affiliated agreements it was noted that the company was not reporting any amounts on Schedule Y, Part 2, Column 8, Management Agreements and Service Contracts. ASIC is a party to two such agreements with American Family Mutual Insurance Company (AFMIC), a cost sharing and a tax allocation agreement. These agreements are discussed in the “Affiliated Agreements” section of this report.

NAIC Annual Statement Instructions – Property and Casualty provide that in Schedule Y, Part 2, an insurer shall report all revenues and expenditures under intercompany contracts for services provided by the insurer, including income tax amounts resulting from tax-sharing agreements, from other affiliates subject to a materiality test. However, under s. Ins 40.03 (5), Wis. Adm. Code, “any transaction related to a management, exclusive agency or similar agreement or which is a service contract or cost-sharing arrangement is a material transaction”. It is recommended that the company report in Schedule Y of its statutory annual statements all transactions among affiliates relating to the cost-sharing and income tax allocation agreements in compliance with s. Ins 40.03(5), Wis. Adm. Code.

Subsequent to examination fieldwork the company has reported transactions between affiliates in the 2002 Schedule Y, Part 2 under Management Agreements and Service Contracts.

Invested Assets

AFMIC entered into a custodial agreement, effective January 1, 1983, with First Wisconsin National Bank on behalf of American Family Group for the safekeeping of most of the group's securities. The examiners' review of this custodial agreement indicated that it did not contain the following clause, as recommended by the NAIC in the Financial Condition Examiners Handbook:

If there is a loss of securities for which the custodian is obligated to indemnify the company, either the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

Also, the clause in the agreement about indemnification by the custodian did not contain all of the NAIC recommended language as included below:

The custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the custodian's custody occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

The review also noted that the agreement had not been updated since inception in 1983. During that time the name of the custodial bank had changed from First Wisconsin to Firststar and then recently to U. S. Bank, which bought Firststar. Also, the agreement mentions Midwest Securities Trust Company (MSTC) as a limited purpose trust company. The agreement states that certain securities are to be deposited in MSTC's non-proprietary account. References to MSTC are no longer valid as AFMIC now uses Depository Trust Company. It is recommended that the company amend the custodial agreement to include the language recommended by the NAIC's Financial Condition Examiners Handbook, to replace references to Midwest Securities with the current trust company, and to replace the custodian with the current one.

During fieldwork the company began meeting with U.S. Bank officials about changing the custodial agreement to address the issues raised in this report.

Affiliated Balances

The company is party to a 100% quota share reinsurance agreement, with the right to offset, with AFMIC. The examination noted that the ceded paid losses and loss adjustment expenses (LAE) were being netted with ceded premium written and then flowing through Line 18 "Payable to parent, subsidiaries and affiliates" on the annual statement. As a result ASIC was not reporting any reinsurance recoverable on paid losses or LAE on Schedule F Part 3 or under "Reinsurance recoverable on loss and loss adjustment expense" and "Ceded reinsurance premiums payable" on the annual statement. NAIC Annual Statement Instructions – Property and Casualty provides that amounts related to reinsurance transactions should be excluded from "Payable to parent, subsidiaries and affiliates" on the annual statement. It is recommended that the company report all affiliated reinsurance transactions on Schedule F and the appropriate lines on the balance sheet as prescribed by the NAIC Annual Statement Instructions – Property and

Casualty. It was decided that since this improper treatment by the company has no effect on surplus, determining the amounts involved in the misclassified reinsurance transactions was not necessary.. Therefore no reclassification was made.

Subsequent to examination fieldwork the company has reported ceded paid losses and LAE on Schedule F and ceded premiums payable on the balance sheet for 2002.

Remittances and Items not Allocated

The examiner's review of Remittances and Items not Allocated noted that the balance contained advance premium payments, i.e., policyholder payments made before year-end 2001 for policies with effective dates in 2002. Advance premiums should have been recorded as a write-in liability in 2001 (and should be on the pre-printed line for Advance premiums in 2002 and subsequent years). Advance premiums do not meet the definition of Remittances and Items not Allocated in SSAP 67. Further discussion on advance premiums is below under Advance Premium Accounting. It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAP 67 and the NAIC's Annual Statement Instructions – Property and Casualty for the reporting of Remittances and Items not Allocated.

Subsequent to fieldwork, the company filed their 2002 annual statement with the Commissioner's office. A review of that statement indicated that the company had reported advance premium on the appropriate line.

Amounts Withheld or Retained by Company for Account of Others

The examiner's review of this account noted that it contained cash receipts that were being held in suspense accounts until proper allocation could be determined. According to the NAIC's Accounting Practices and Procedures Manual SSAP 67, this liability should contain amounts the company is holding in a fiduciary capacity, such as employees' federal tax withholdings. Unallocated cash receipts, such as premium payments received with an application for a new policy, are considered Remittances and Items Not Allocated according to the NAIC's

Accounting Practices and Procedures Manual SSAP 67. It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAP 67 and the NAIC's Annual Statement Instructions – Property and Casualty for the reporting of unallocated cash receipts.

Advance Premium Accounting

The examiners reviewed the company's reporting of policyholder advance premium payments. When a policyholder pays an installment in advance of the policy's effective date (e.g. December 2001 installment payment of \$100 for a policy with a \$400 annual premium and a January 2002 effective date) the company's IT system reports the entire full term premium (\$400) as advance premium and reports the remaining installments (\$300) as premium receivable. (The correct accounting is to record only the \$100 as advance premium, with no premium receivable until the effective date of the policy.) As a result, the company has overstated both the liability and the asset by the amount of the remaining installments. This accounting treatment had no effect on reported surplus.

According to the NAIC's Accounting Practices and Procedures Manual SSAP 53, "advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date". Pursuant to SSAP 6, premiums are to be recorded on the effective date of the policy, so the company does not have a receivable for the unpaid portion of the premium until the effective date of the policy. It is recommended that the company record only the portion of premium actually received as advance premium in compliance with the NAIC's Accounting Practices and Procedures Manual SSAPs 6 and 53.

The company has begun to work on EDP system modifications to correctly record receipts of advance premiums.

VIII. CONCLUSION

ASIC is in a holding company system referred to as the “American Family Insurance Group.” ASIC writes primarily nonstandard personal lines automobile policies in 15 states and cedes this business to AFMIC. In order for ASIC to meet the capital requirements for licensing in new states, AmFam, Inc. contributed \$2.25 million in capital and surplus to ASIC. In 2000, ASIC and AFMIC entered into an agreement whereby AFMIC would agree to buy all premium receivables from ASIC.

During the period under examination, the company’s surplus increased by about \$35 million. ASIC reported net income in each of the past five years. The examination determined that the company complied with the recommendation of the previous examination. The current examination made six recommendations and no adjustment to reported surplus or reclassification of balance sheet items. A review of the 2002 annual statement indicated that three of these recommendations had already been complied with.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Financial Reporting – Schedule Y —It is recommended that the company report in Schedule Y of its statutory annual statements all transactions among affiliates relating to the cost-sharing and income tax allocation agreements in compliance with Ins 40.03(5), Wis. Adm. Code.
2. Page 22 Affiliated Balances —It is recommended that the company report all affiliated reinsurance transactions on Schedule F and the appropriate lines on the balance sheet as prescribed by the NAIC Annual Statement Instructions – Property and Casualty.
3. Page 22 Invested Assets —It is recommended that the company amend the custodial agreement to include the language recommended by the NAIC's Financial Condition Examiners Handbook, to replace references to Midwest Securities with the current trust company, and to replace the custodian with the current one.
4. Page 23 Remittances and Items not Allocated —It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAPs 53 and 67 and the NAIC's Annual Statement Instructions – Property and Casualty for the reporting of Remittances and Items not Allocated.
5. Page 23 Amounts Withheld or Retained by Company for Account of Others —It is recommended that the company comply with the NAIC's Accounting Practices and Procedures Manual SSAP 67 and the NAIC's Annual Statement Instructions – Property and Casualty for the reporting of cash receipts that cannot be identified for a specific purpose.
6. Page 24 Advance Premium Accounting —It is recommended that the company record only the portion of the premium actually received as advance premium in compliance with the NAIC's Accounting Practices and Procedures Manual SSAPs 6 and 53.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Andy Fell	Insurance Financial Examiner
Don Gasser	Insurance Financial Examiner
Amy Wolff	Insurance Financial Examiner
John Litweiler	Insurance Financial Examiner
Rebecca Easland	Insurance Financial Examiner
Randy Milquet	EDP Specialist

Respectfully submitted,

Eleanor Opprieht
Examiner-in-Charge